DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0476
Adjusted Gross Income Tax
For Tax Years 1991 through 1993

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ISSUE

I. Corporate Income Tax—Apportionment Factor Calculations

Authority: IC 6-3-2-2; IC 6-8.1-5-1; 45 IAC 2.2-4-27; 45 IAC 3.1-1-40; 45 IAC 3.1-1-63; MTC model regulation IV.18 (1986)

Taxpayer protests the numbers used by the Department in determining rental expenses in the property factor of the apportionment factor.

STATEMENT OF FACTS

Taxpayer operates a delivery service. Taxpayer hires independent contractors to pick up packages at customer locations and deliver to other locations in the other states. Independent long-distance haulers provide the transportation link. Those haulers pick up the packages at the terminals and deliver to another terminal. Independent intercity drivers make subsequent deliveries. Taxpayer protests the numbers used by the Department in determining rental expenses in the property factor of the apportionment factor for Indiana returns.

I. Corporate Income Tax—Apportionment Factor Calculations

DISCUSSION

Taxpayer protests assessments made by the Department of Revenue on taxpayer's 1991, 1992 and 1993 corporate income taxes. Taxpayer believes that the Department overestimated the portion of rental payments to independent truck drivers which was apportioned to truck rental as opposed to driver salary. The Department allocated eighty percent (80%) of the rental payments to truck rental and twenty percent (20%) to driver

salary. Taxpayer believes the actual breakdown is closer to 20% for truck rental and 80% for driver salary.

Taxpayer believes that rented equipment should not be included in the property factor of the apportionment calculation, and refers to IC 6-3-2-2(c), which states:

> The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the taxable year. However, with respect to a foreign corporation, the denominator does not include the average value of real or tangible personal property owned or rented and used in a place that is outside the United States. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight (8) times the net annual rate. Net annual rental rate is the annual rate paid by the taxpayer less any rental rate received by the taxpayer from subrentals. The average of property shall be determined by averaging the values at the beginning and ending of the taxable year but the department may require the averaging of monthly values during the taxable year if reasonably required to reflect properly the average value of the taxpayer's property.

Taxpayer does not believe that the phrase "rented" property was intended to include equipment used by the owner-operators. Taxpayer refers to 45 IAC 2.2-4-27(d)(3)(A), which states:

> The renting or leasing of tangible personal property, together with the services of an operator shall be subject to the tax when control of the property is exercised by the lessee. Control is exercised when the lessee has exclusive use of the property, and the lessee has the right to direct the manner of the use of the property. If these conditions are present, control is deemed to be exercised even though it is not actually exercised.

Taxpayer states that control of the equipment remains with the owner-operator at all times. Taxpayer believes that since it did not control the trucks it should not have to include owner-operator equipment in the property factor.

The Department points out that 45 IAC 2.2-4-27 deals with Sales and Use Tax, while the tax in this case is Adjusted Gross Income Tax. The relevant regulation for Adjusted Gross Income Tax is 45 IAC 3.1-1-40, which states:

> The property factor is a fraction, the numerator of which is the average value of the taxpayer's Indiana property, and the denominator of which is the total value of the taxpayer's property everywhere. As used in this regulation [45 IAC 3.1-1-40], the word "property" includes all real and tangible personal property of the taxpayer, whether owned or rented, which is or could be used to produce business income during the tax period. This includes land, buildings, machinery,

> inventory, *equipment* and any other real or tangible personal property used to produce business income, but not coin, currency or intangibles. Property, the income from which is subject to allocation as nonbusiness income, is excluded from the factor. Property producing both business and nonbusiness income is included only to the extent it was used to produce business income. (Emphasis added.)

Since there is a regulation which specifically states that rented equipment is to be included in the property factor for Adjusted Gross Income Tax purposes, the Department is unpersuaded by the reference to the Sales and Use Tax regulation. The rented equipment was properly included in the property factor.

Taxpayer next states that if the equipment is to be included in the property factor, then the value of the equipment should be determined through different methods than those used by the auditor. The auditor relied on 45 IAC 3.1-1-63(A), which states:

> Fixed properties such as buildings and land used in business, shop and terminal equipment and trucks or cars used locally or any other tangible property connected with the transportation business, will be assigned to the state in which such properties are located.
>
> The value of all movable equipment used in interstate transportation will be assigned to this State on the basis of total miles traveled in this State, as compared to total miles traveled everywhere. Fixed and movable property will then by combined to arrive at the total property factor, Indiana property over property everywhere.
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> Property owned by the transportation company is valued at original cost. Property rented is valued at eight (8) times the annual rental rate less any annual subrental.

The auditor excluded 20% of the lease costs, in order to exclude driver's salaries from the calculations, and multiplied the remainder by eight as provided in 45 IAC 3.1-1-63(A). Taxpayer believes that 80% of the lease costs should have been excluded to accurately reflect the value of the leased trucks.

Indiana may follow MTC regulations, but is not bound by those regulations. Regarding rented transportation property, MTC regulation IV.18(g), adopted in 1986, discusses rented property as part of the property factor in the apportionment calculation as follows:

> "Purchased transportation," defined as "the taxpayer's use of a motor vehicle owned and operated by another…for which a charge is incurred," is to be included in the calculation of rented property, which is valued at eight times the net annual rental rate. When the charge for the use of such purchased property cannot be separated from the charge for compensating the operator of the property, the value of the total charge is to be reduced by 20%.

Since taxpayer was unable to separate the charge for the use of the rented property from the charge for compensating the operator of the property, the Department reduced the value of the total charges by 20%.

Taxpayer explains that it did not calculate its payments to the owner-operators based on equipment, operator and maintenance. Taxpayer submitted its own calculations of the value of the trucks it rented for the tax periods in question. Since taxpayer did not own the vehicles, it does not know the exact number or price of the vehicles, and therefore estimated the number and cost of these vehicles. Taxpayer points out that it used current values (1999-2000) for such vehicles rather than values from the years in question (1991-1993) in order to make a good faith overestimation of the value of the vehicles. Using these methods, taxpayer arrived at the figures of between 15%-20% of rental expenses it believes go to capitalization of trucks. The remaining 80%-85%, taxpayer believes, goes to driver salaries.

Taxpayer has submitted calculations in which it estimated the numbers of trucks, estimated the cost of the trucks and estimated the number of years the owner-operators would take to pay off the cost of the trucks. Taxpayer believes that these figures more closely reflect the value of the rented trucks. The Department is not convinced by these calculations. Taxpayer does not know for certain how many trucks were used. Also, those numbers concerning truck capitalization which support taxpayer's position were derived from calculations where the numerator was estimated and the denominator was estimated. IC 6-8.1-5-1(a) provides in part:

> The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid, and the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

Taxpayer has not met the burden of proving that the proposed assessments are wrong. The calculations taxpayer used to arrive at its figures were based on estimated number of trucks, estimated values of trucks, estimated years for capitalization, and estimated driver salaries. Even though those may be good faith estimations, they are still estimations, and do not meet the burden imposed by IC 6-8.1-5-1(a).

Also, in its original protest letter, taxpayer expressed that it believed that the auditor should not have included rigs and vans together for the mileage percentage. Taxpayer explained that the rigs were used for long-distance hauling, while the vans for the most part operated locally. Taxpayer objected to the fact that the auditor "lumped these two disparate types of operations into one and allocated them on a total mileage percentage although the mileage ran by one type of operation has no bearing on the other.", but offered no explanation of why this is incorrect.

In conclusion, the rented trucks were properly included in the property factor, as provided in 45 IAC 3.1-1-40. The auditor excluded 20% of the rental charges, in order to

eliminate service charges, as provided in MTC IV.18(g). The auditor then multiplied the remaining amount by eight, as provided in IC 6-3-2-2(c). The taxpayer did not meet the burden of proving that the proposed assessment is wrong, as imposed by IC 6-8.1-5-1(a).

FINDING

Taxpayer's protest is denied.

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